

Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330. (This is a PLR.)

November 29, 2005

Dear Xxxxx:

This letter is in response to your letter dated January 23, 2004, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

On behalf of our client, COMPANY, we respectfully request the Illinois Department of Revenue issue a Private Letter Ruling pursuant to 2 Ill. Adm. Code Section 1200.110 with respect to the following factual situation.

General Information

1. Enclosed please find an original Form IL-2848 Power of Attorney, authorizing FIRM to represent COMPANY (the 'Company') before the Illinois Department of Revenue (the 'Department').
2. This Private Letter Ruling ('PLR') is not requested with regard to hypothetical or alternative proposed transactions. The PLR is requested to determine the Retailer's Occupation Tax and Use Tax consequences of the actual business practices of the Company.
3. The Company is not currently engaged in litigation with the Department in regard to this or any other tax matter.

4. The Company is not currently under audit by the Department in regard to any tax matter.
5. To the best knowledge of the Company's personnel, the Department has not previously ruled regarding this matter for the Company. In addition, the Company has not submitted the same or similar issue to the Department.
6. The Company requests that certain information be deleted from the PLR prior to dissemination to others. The Company requests that its name, address, location of its facility and the name of its representative be deleted.
7. The Company knows of no authority contrary to the authorities referred to and cited below.

Statement of Material Fact

1. The Company is engaged in the operation of an ethanol production facility.
2. The Company will process nearly 15 million bushels of corn into 40 million gallons of ethanol and 120,000 tons of distillers dried grains with solubles (DDGS) annually. Ethanol, a renewable fuel made primarily from corn, is principally used as a gasoline additive to enhance octane and increase the oxygen level in the fuel so that it burns more cleanly, improving the quality of vehicle emissions and engine performance.
3. The facility is located within the CITY Enterprise Zone.
4. The Company has purchased the significant materials (see below) required for the facility and contracted with a contractor (hereafter referred to as the 'GWC') for the installation of the materials.
5. The following items represent the significant materials that will be purchased from a retailer within the enterprise zone for incorporation into the facility. These materials will be referred to hereinafter as 'the materials:'
 - a) Tanks
 - b) Fermenters
 - c) Rectifier column, side strippers and molecular sieve systems
 - d) Centrifuges and dryer systems
 - e) Heat exchangers, a chiller and a cooling tower
 - f) Thermal Oxidizer/Heat Recovery Steam Generator
 - g) Siemens/Moore APACS distributed control system
 - h) Piping and pumps
 - i) Buildings, foundations, footings and concrete
6. All materials were purchased after August 6, 2002.
7. Exemption certificates have been provided to the vendors for the purchases described above.

The Production Process

The Company is engaged in the production of ethanol, which is considered a manufacturing activity in Illinois. The Company operates from a facility in CITY, Illinois, which is located within an enterprise zone. The project has been certified by the Department of Commerce and Community Affairs ('DCCA', now DCEO.)

The Company has put in place a manufacturing process, using the equipment listed above, which results in the production of tangible personal property. The process is accomplished as follows.

Trucks deliver corn to an initial holding pit where it is weighed. The corn is then lifted from the pit by two 15,000 bushel legs, whereupon it is run through a scalper to remove rocks and debris.

The corn is then ground and mixed in a slurry tank, after which it is routed through a pressure vessel and cooked using steam in a flash vessel. The steam is produced by a thermal oxidizer and Heat Recovery Steam Generator described below. The corn is then in the form of a cooked mash, which is routed through liquification tanks into one of three fermenters. As the cooked mash is filling the fermenter, propagated yeast is added.

The after product of the fermentation is beer and corn mash, which are pumped into a beer well and then a beer column where the alcohol is vaporized from the mash. The alcohol streams from the beer are then dehydrated through the rectifier column, the side stripper; and the molecular sieve system before the alcohol is pumped into a tank farm shift tank. The alcohol is blended with gasoline as the product is being pumped into a final storage tank.

The remaining corn mash is sent through the centrifuges and dryers until it has reached 10% moisture. This process is intended to render the corn mash into a form where it can be sold as cattle feed.

The overall control of these manufacturing processes is accomplished using the Siemens/Moore system and three user terminals, through which the majority of the plant's operations are monitored and controlled.

The thermal oxidizer and heat recovery steam generator is employed to recover heat in the form of steam which is used to process and cook the corn mash and provide power for the manufacturing process. The thermal oxidizer waste heat boiler combination is designed to operate in conjunction with or independent of the drying system. This energy is then used to provide all of the steam required to drive the manufacturing, process.

Once sufficient temperatures are reached the exhaust gas leaves the thermal oxidizer and is passed through a Heat Recovery Steam Generator ('HRSG'). This will generate steam for the process which is used to cook the corn mash and produce a substantial change on the product. Second, third and fourth heat exchangers are incorporated to remove additional heat; boiler feed water, cook water and boiler make-up water. The exhaust stream is then sent to a stainless steel stack where it is vented.

Process piping and conveyors are also used to transport the product through the manufacturing process.

In addition to the foregoing, an administration building has been constructed on the site. There are also various concrete footings and foundations used to support the machinery and equipment.

Ruling Requested

The major materials identified and described in this letter qualify either as 'manufacturing and assembling machinery and equipment' or 'building materials' for the purpose of the Retailer's Occupation Tax exemptions provided in 35 ILCS 120/5k; 35 ILCS 105/3-5(18) and 86 Ill. Admin. Code Section 30.1951(a)(7).

Relevant Authorities

Manufacturing Machinery and Equipment

The Illinois Retailers' Occupation Tax Act [35 ILCS 120/2] imposes a tax on persons engaged in the business of making retail sales of tangible personal property. In accordance with Section 2-10 of the Act, this tax is measured by a seller's gross receipts [35 ILCS 120/2-10].

35 ILCS 105/3-5(18) provides an exemption for:

Manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, whether that sale or lease is made directly by the manufacturer or by some other person, or whether that sale or lease is made apart from or as an incident to the seller's engaging in the service occupation of producing machines, tools, dies, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser.

86 Ill. Admin. Code Sec. 130.330(d)(3)(D) states:

By way of illustration and not limitation, the following activities will generally be considered to constitute an exempt use:

The use of machinery and equipment to convey, handle, or transport the tangible personal property to be sold within production stations on the production line or directly between such production stations or buildings within the same plant;

In order to qualify for the exemption for manufacturing machinery and equipment, the materials must be primarily used in the manufacturing process. Items that may be essential to the manufacturing process, are not necessarily used in the process, and therefore may not qualify for the exemption.

The Department in Private Letter Ruling 97-0007 (March 5, 1997) ruled that materials such as piping and tanks that are used to transport products between manufacturing stations qualify for the manufacturing machinery and equipment exemption, while similar items that are used before or after production ends do not qualify.

The same ruling states that a cooling tower that is used primarily (over 50%) to maintain machinery and equipment that qualify for the exemption also qualifies as manufacturing machinery and equipment.

Therefore, the first question is which of the materials are primarily used in the manufacturing process or are specifically identified by the Illinois Department of Revenue as qualifying for the exemption.

Building Materials in an Enterprise Zone

Pursuant to Section 5k of the Act [35 ILCS 120/5k], a retailer who makes sales of 'building materials' to be incorporated into real estate within the enterprise zone by remodeling, rehabilitation or new construction, may deduct receipts from such sales in the calculation of taxable gross receipts.

In order to qualify for the exemption as provided in 35 ILCS 120/5k, the materials must constitute 'building materials' as provided in 86 Ill. Adm. Code Sec. 130.1951(a)(7).

86 Ill. Admin. Code Sec. 130.1951(a)(7) provides:

In order to qualify for the deduction, the materials being purchased must be building materials. That is, they must be purchased for *physical incorporation* into real estate. (Emphasis added)

Therefore, the question is whether the materials described in this letter will qualify as 'building materials,' that is, whether the materials are purchased for 'physical incorporation into real estate.'

The Department in Private Letter Ruling 99-0009 (March 9, 1999) ruled that pipe racks, pipe, supports, and piping tie-ins installed at a natural gas fired power plant would constitute 'building materials' under the Department's regulations because they were permanently affixed to real estate. Further, since the real estate was located within an enterprise zone such items incorporated into real estate could be purchased tax -free from qualified retailers.

In a more recent decision, the Department in Private Letter Ruling ST 00-0013 (July 7, 2000) found that certain materials incorporated into realty within an electricity generating facility qualified as a building material pursuant to the Department's regulations. The Department found that turbine generators, electrical transformers, electrical cabling, piping and other materials that are permanently affixed to real estate qualify as a 'building material' for purposes of the exemption provided in 35 ILCS 120/5k and 86 Ill. Admin. Code Sec. 1951(a)(1).

The facts and issues stated in ST 00-0013 are virtually identical to the issues at hand in this letter ruling request. The materials at issue here will be permanently and physically attached to the realty. Removal of the materials after affixation would result in substantial damage to the materials and realty. The anchor bolts, which are embedded in the concrete foundation, would have to be removed. Removing the anchor bolts would cause damage to the anchor bolts, the foundation and piping. Therefore, this demonstrates that the equipment, after being attached, is permanently affixed.

Conclusions

35 ILCS 105/3-5(18) allows an exemption on machinery and equipment that is used primarily in manufacturing or assembling tangible personal property.

- a) The initial loading tank and two 15,000 bushel legs which are used to lift the corn to a scalper to remove the rocks and debris should qualify for the manufacturing machinery and equipment exemption. The scalper should also qualify for the manufacturing machinery and equipment exemption.
- b) Tanks that are used between stations in the manufacturing process qualify for the manufacturing machinery and equipment exemption.
- c) Fermenters cause a change in the product and qualify for the manufacturing machinery and equipment exemption.
- d) The rectifier column, side strippers and molecular sieve systems cause a change in the product and qualify for the manufacturing machinery and equipment exemption.
- e) Centrifuges and dryer systems cause a change in the product and qualify for the manufacturing machinery and equipment exemption.
- f) Heat exchangers, a chiller and a cooling tower primarily maintain machinery and equipment that qualify as manufacturing machinery and equipment and therefore qualify for the exemption as well.
- g) The Thermal Oxidizer and Heat Recovery Steam Generator together produce steam, which is used to cook the corn mash and should be considered part of the manufacturing process.
- h) The Siemens/Moore APACS distributed control system is CAM equipment that runs manufacturing machinery and equipment and therefore qualifies for the exemption as well.
- i) Piping and pumps that are used between stations in the manufacturing process qualify for the manufacturing machinery and equipment exemption.

35 ILCS 120/5k provides that a retailer whose place of business is located within a county or municipality which has established an enterprise zone, and who makes sales of 'building materials' to be incorporated into real estate in that enterprise zone by remodeling, rehabilitation or new construction, may deduct receipts from such sales in the calculation of taxable gross receipts.

The exemption provided in 35 ILCS 120/5k is applicable to receipts from the sales of 'building materials.' In order to qualify as 'building materials,' the items must be physically incorporated into real estate.

The following materials qualify as 'building materials' for purposes of the exemption provided in 35 ILCS 120/5k. The materials are physically and permanently incorporated into realty as described in this letter. Therefore, since the materials qualify as building material and are incorporated into realty within an enterprise zone, the materials may be purchased from a qualifying retailer free from Retailer's Occupation Tax and Use Tax.

- a) Tanks that are used in pre-production or post-production stages.
- b) Piping and pumps that are used in pre-production or post-production stages.
- c) Buildings, foundations and footings.

In the event that the Thermal Oxidizer, Heat Recovery Steam Generator, or any of the other tanks installed at the site are deemed to not qualify for the manufacturing exemption, we request the opportunity to demonstrate that these items are permanently affixed to real estate within the enterprise zone and thus may also qualify for the building materials exemption.

We respectfully request that the Department issue a ruling stating that the procedures outlined in this letter satisfy the Department's regulations found at 86 Ill. Admin. Code Section 130.1951 to qualify either for the manufacturing machinery and equipment or the enterprise zone exemption.

If the Department can not conclude that the procedures outlined above conform to the Department's regulations or that the materials qualify as neither 'manufacturing machinery and equipment' or 'building materials,' I request the Department contact me to determine what additional information is required or allow the taxpayer to rescind this ruling request.

DEPARTMENT'S RESPONSE:

The Retailers' Occupation Tax does not apply to sales of machinery and equipment used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Admin. Code 130.330. When determining whether a piece of equipment qualifies for the manufacturing machinery and equipment exemption, the requirements of 86 Ill. Admin. Code 130.330 must be met.

"Manufacturing", as defined in this regulation, is the production of articles of tangible personal property, whether such articles are finished products or articles for use in the process of manufacturing or assembling different articles of tangible personal property by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant, See 86 Ill. Admin. Code 130.330(b)(2).

Items that qualify for the manufacturing machinery and equipment exemption generally do not include the use of machinery or equipment to store, convey, handle or transport materials or parts or sub-assemblies prior to their entrance into the production cycle. See 86 Ill. Admin. Code 130.330(d)(4)(c). Therefore the pre-production process of the trucks delivering the corn to the initial holding pit where the corn is weighed would not qualify for the manufacturing machinery and equipment exemption. In addition, the two (2) 15,000 bushel legs lifting the corn would not qualify for the exemption as these processes are prior to the production process.

The following additional machinery and equipment referred to in your request may qualify for the manufacturing machinery and equipment exemption providing it is used primarily (over 50%) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease pursuant to the guidelines and requirements of 86 Ill. Admin. Code 130.330: fermenters, rectifier column, side strippers, molecular sieve systems, centrifuges, dryer systems, heat exchangers, chiller and cooling tower, heat recovery steam generator, and the Siemens/Moore APACS control system.

Please note, the test to claim the manufacturing machinery and equipment exemption is not whether any State or Federal Agency requires certain conditions be met. The fact that a particular piece of machinery or equipment, such as the thermal oxidizers, may be considered essential to the conduct of the business of manufacturing or assembling because its use is required by law or practical necessity does not, of itself, mean that the machinery or equipment is used primarily in manufacturing or assembling. See 86 Ill. Admin. Code 130.330(d)(2). However, providing that the thermal oxidizers are used primarily in the manufacturing or assembling process to cause a change in the existing corn mash and feed into tangible property with a different form, use or name, then they would qualify for the manufacturing machinery and equipment exemption.

As you are aware, 86 Ill. Adm. Code 130.330(c)(5) states "Machinery and equipment does not include foundations for buildings to house or support, machinery and equipment. Therefore the administration building and footings referred to in your request would not qualify for the manufacturing machinery and equipment exemption. It is correct that a deduction from Illinois Retailers' Occupation Tax liability exists for gross receipts from retail sales of building materials that will be incorporated into real estate located in an enterprise zone established by a county or municipality under the Illinois Enterprise Zone Act by remodeling, rehabilitation or new construction. See 86 Ill. Adm. Code 130.1951. It would appear that the buildings, foundations and footings would qualify for the building materials exemption provided that the purchase of these items meet the requirements of 86 Ill. Adm. Code 130.1951.

We are unable to conclusively conclude that the tanks, pumps and piping used in the pre-production and postproduction stages would qualify for the building materials exemptions for buildings located in an enterprise zone. The Department's auditors would be in the best position to make this determination on a case-by-case basis after a careful investigation. The materials must be building materials permanently affixed to realty located within an enterprise zone. Please refer to 86 Ill. Adm. Code 130.1951 for a determination of the tax liabilities for this equipment.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Edwin E. Boggess
Associate Counsel

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